

## Message Text

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PAGE 01 EC BRU 09877 132033Z

62

ACTION EUR-12

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CIEP-01 TRSE-00 SS-15 STR-01 OMB-01 CEA-01 CIAE-00

COME-00 FRB-01 INR-05 NSAE-00 XMB-02 OPIC-03 LAB-04

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E.O. 11652: N/A

TAGS: EFIN, EEC

SUBJECT: EC CONSIDERS JOINT ACTION TO SMOOTH OUT DOLLAR EXCHANGE RATE

FLUCTUATIONS

1. SUMMARY: AN EC EXPERT GROUP HAS PROPOSED THAT EC CENTRAL BANKS UNDERTAKE TO KEEP THE DAILY EXCHANGE RATE FLUCTUATIONS OF COMMUNITY CURRENCIES AGAINST THE DOLLAR TO NO MORE THAN ONE PERCENT. THE EC MONETARY COMMITTEE FAVORS THIS PROPOSAL BUT THE COUNCIL (FINANCE) AND CENTRAL BANK GOVERNORS HAVE NOT YET GIVEN THEIR APPROVAL. THE EC WOULD CONSULT WITH THE US BEFORE IMPLEMENTING THE PROPOSAL. END SUMMARY.

2. PROPOSED EXCHANGE RATE POLICY: AN EXPERT GROUP OF THE EC COMMITTEE OF CENTRAL BANK GOVERNORS (THE HEYVAERT - FORMERLY THE THERON - GROUP) HAS PROPOSED THAT EC CENTRAL BANKS AGREE TO SMOOTH OUT THE FLUCTUATIONS

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PAGE 02 EC BRU 09877 132033Z

OF EUROPEAN CURRENCIES AGAINST THE DOLLAR. EACH EC CENTRAL

BANK WOULD AGREE TO INTERVENE IN THE MARKET WHEN ITS EXCHANGE RATE FLUCTUATES BY MORE THAN 0.75 PERCENT AGAINST THE PREVIOUS DAY'S DOLLAR RATE. EACH BANK WOULD ALSO ENDEAVOR TO KEEP THE DAILY CHANGE WITHIN AT LEAST ONE PERCENT OF THE PREVIOUS DAY'S RATE. THIS LOOSE ARRANGEMENT WOULD REQUIRE CENTRAL BANKS TO CONSULT WITH THEIR EC PARTNERS SHOULD THEY DECIDE TO ALLOW THE DAILY DOLLAR RATE TO CHANGE BY MORE THAN ONE PERCENT.

3. PURPOSE OF PROPOSAL: THE EXPERT GROUP'S CONFIDENTIAL REPORT (COPIES OF WHICH ARE BEING POUCHED TO ACTION ADDRESSES) CITES THREE IMMEDIATE PURPOSES OF THIS PROPOSAL: 1) IT WOULD REDUCE THE RECENT ERRATIC MOVEMENTS IN EXCHANGE MARKETS; 2) IT WOULD REASSURE THE MARKET; AND 3) IT WOULD HELP UNIFY EC CURRENCIES. IN THE LONGER TERM, ACCORDING TO THE REPORT SUCH A POLICY WOULD PREPARE THE WAY FOR EC FLOATING CURRENCIES TO EVENTUALLY REJOIN THE "SNAKE."

4. IMPROVED COORDINATION OF EC INTERVENTIONS: THE REPORT PROPOSES THAT CENTRAL BANKS INTERVENE IN THE EXCHANGE MARKETS WITH STRONG EUROPEAN CURRENCIES AS WELL AS DOLLARS TO HELP STABILIZE THE DOLLAR RATE. FOR EXAMPLE, IF THE DM IS STRONG AND THE DANISH KRONER IS WEAK VIS-A-VIS THE DOLLAR, DENMARK MIGHT BUY DM WHILE THE FRG BUYS DOLLARS. THIS WOULD ENABLE EC INTERVENTIONS TO REINFORCE EACH OTHER.

5. EC REACTION TO PROPOSAL: THE EC MONETARY COMMITTEE SUPPORTS THE EXPERT'S PROPOSAL IN ITS REPORT FOR THE COUNCIL (FINANCE) MEETING ON DECEMBER 19. COMMISSION OFFICIALS INDICATE THAT MEMBER STATES GENERALLY FAVOR THE PROPOSAL. THE COUNCIL, HOWEVER, IS EXPECTED ONLY TO TAKE NOTE OF THE PROPOSAL BECAUSE THE CENTRAL BANK GOVERNORS WILL MAKE THE FINAL DECISION ON WHETHER TO IMPLEMENT IT. COMMISSION OFFICIALS SAY THAT THAT THE DECEMBER 15 MEETING IN FRANKFURT OF THE COUNTRIES PARTICIPATING IN THE "SNAKE" WILL DISCUSS HOW TO HARMONIZE THIS PROPOSAL WITH EXISTING "SNAKE" INTERVENTION LIMITED OFFICIAL USE

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PAGE 03 EC BRU 09877 132033Z

ARRANGEMENTS. A NORWEGIAN OFFICIAL HERE INFORMS US THAT NORWAY AND SWEDEN HAVE BEEN INVITED TO THE FRANKFURT MEETING IN ORDER TO DISCUSS THE POSSIBILITY OF BROADENING THE EC PROPOSAL.

6. CONSULTATION WITH THE US: THE EXPERT GROUP'S REPORT SUGGESTS THAT THE NEW YORK FEDERAL RESERVE BANK BE CONSULTED ON THIS PROPOSAL. IT ADDS THAT THE SS WOULD

WOULD HAVE TO AGREE BEFORE THE PROPOSAL COULD BE IMPLEMENTED. THE EXPERTS' REPORT INDICATES IT WOULD BE IN US INTEREST TO COOPERATE IN STABILIZING FLUCTUATIONS OF THE DOLLAR RATE. IT NOTES, HOWEVER, THAT THE TIME DIFFERENCE BETWEEN THE US AND EUROPE COULD CREATE PROBLEMS. THE REPORT PROPOSES USING AS A REFERENCE THE EX CHANGE RATES AT THE CLOSING OF EUROPEAN MARKETS. THESE RATES, OF COURSE, WOULD LIKELY BE DIFFERENT FROM THE NEW YORK CLOSING RATES WHICH COULD CREATE ARBITRAGE DIFFICULTIES. GREENWALD

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